BLACK, J.

Supreme Court of the United States

OCTOBER TERM, 1961

No. 66

ISADORE BLAU, a stockholder of Tide Water Associated Oil Company, suing on behalf of himself and all other stockholders similarly situated and on behalf of and in the right of Tide Water Associated Oil Company,

Petitioner,

—against—

ROBERT LEHMAN, ALLAN S. LEHMAN, JOHN HERTZ, JOHN M. HANCOCK, MONROE C. GUTMAN, PAUL M. MAZUR, WILLIAM J. HAMMERSLOUGH, FRANCIS A. CALLERY, FREDERICK L. EHRMAN, JOHN R. FELL, WILLIAM S. GLAZIER, PHILIP H. ISLES, HERMAN H. KAHN, EDWIN L. KENNEDY, FRANK J. MANHEIM, PAUL E. MANHEIM, MORRIS NATELSON, HAROLD J. SZOLD and JOSEPH A. THOMAS, a co-partnership, doing business under the firm name and style of Lehman Brothers, JOSEPH A. THOMAS, and TIDE WATER ASSOCIATED OIL COMPANY,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENTS OTHER THAN TIDE WATER ASSOCIATED OIL COMPANY

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C ES CITED

STATUTES

MISCELLANEOUS

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A

Opinions Below

The opinions of the Court of Appeals (R. 174-192; 198-203) are reported at 286 F. 2d 786. The opinion of the District Court (R. 149a-157a) is reported at 173 F. Supp. 590.

Jurisdiction

The judgment of the Court of Appeals was entered on December 20, 1960 (R. 193). A petition for rehearing was denied by the Court of Appeals on February 21, 1961 (R. 198-199). The petition for a writ of certiorari was filed on March 14, 1961 and granted on April 24, 1961. The jurisdiction of this Court was invoked under 28 U. S. C. § 1254 (1).

Statutes Involved

The relevant sections of the Securities Exchange Act of 1934 provide:

> Section 3(a) (Title 15 U. S. C. § 78c(a))
>
> "When used in this chapter, unless the context otherwise requires—
>
> * * *
>
> (7) The term 'director' means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."
>
> Section 16(a) (Title 15 U. S. C. § 78p (a))
>
> "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security, shall file, at the time of the

registration of such security or within ten days after he becomes such beneficial owner, director, or officer, a statement with the exchange (and a duplicate original thereof with the Commission) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been any change in such ownership during such month, shall file with the exchange a statement (and a duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

Section 16(b) (Title 15 U. S. C. § 78p(b))

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized.

This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 23(b) (Title 15 U. S. C. § 78w(b))

"The Commission and the Board of Governors of the Federal Reserve System, respectively, shall include in their annual reports to Congress such information, data, and recommendation for further legislation as they may deem advisable with regard to matters within their respective jurisdictions under this chapter."

Questions Presented

1. Was not the Court of Appeals correct in holding that a partnership, one of whose members is a director of an issuer, is not liable to account to the issuer for short swing profits realized by its non-director partners, and in holding that the partner who was a director is not liable to account for more than what would have been his pro rata share of such profits had he received it, especially where the Court of Appeals concurred in the findings of the District Court (a) that the partner-director was not acting on behalf of the partnership as a director, and (b) that the partnership's purchases and sales of securities of the issuer were not initiated by such director nor were they based on any confidential information imparted by him.

2. Was not the Court of Appeals correct in holding that the District Court did not abuse its discretion in refusing to award interest on that amount which would have been the partner-director's pro rata share had he received it?

Statement

The facts as they appear in the record and as found by the courts below are as follows:

In 1954 respondent John Hertz, then a partner of Lehman Brothers, resigned all but one of eight to ten directorships then held by him, including his directorship on the Board of Tide Water (R. 61a, 38a, 150a). Mr. Hertz testified that there was no discussion among his partners about "getting" another member of the firm in Hertz's place on the Tide Water board (R. 63a). After resigning from Tide Water, Mr. Hertz spoke with Mr. Staples, President of Tide Water, and recommended respondent Joseph A. Thomas, a partner of Lehman Brothers, as a prospective director of Tide Water (R. 64a, 150a). Mr. Hertz told Mr. Staples that he "had a very smart young partner who knew much more about the oil business than [he] did" (R. 64a). At that time Mr. Thomas was a member of the board of directors of a number of banking and industrial corporations (R. 33a). Mr. Hertz then asked Mr. Thomas whether he would like to become a director of Tide Water and Thomas said that he would (R. 64a, 150a). Hertz never heard any more about it (R. 64a). Mr. Thomas was subsequently introduced to Mr. Staples by John Schiff, a partner of the investment banking firm of Kuhn, Loeb & Company and a director of Tide Water (R. 36a, 37a, 137a, 150a, 179). Mr. Staples and Mr. Thomas lunched together several times and "after a month or two he rang me up one day and asked me if I would like to be a director . . ." (R. 36a, 150a). Mr. Thomas was elected to the Tide Water board on August 5, 1954 (R. 32a, 38a).

Mr. Thomas had no discussion with any of his partners with regard to Mr. Staples' invitation except that Thomas,

naturally pleased with Tide Water's offer, told respondent Robert Lehman, his senior partner, of the invitation (R. 41a). Mr. Lehman congratulated Mr. Thomas but did not urge him to accept the invitation (R. 41a). Respondent William Glazier testified that no members of the firm in his presence or to his knowledge suggested to Mr. Thomas that he attempt to be elected a director of Tide Water (R. 85a). Respondent Monroe C. Gutman testified that he never discussed with any member of the firm nor ever heard any discussion among any partners of Lehman Brothers that Mr. Thomas had been proposed for the Tide Water board of directors (R. 80a). Respondent William J. Hammerslough testified that he had no discussions with Mr. Thomas or anyone else relating to Thomas' election to the Tide Water board (R. 72a, 73a), and that he did not have any discussions with any of his partners or know of any discussions concerning the advisability of having one of his partners "take Mr. Hertz's place" on the Tide Water board (R. 73a). During Thomas' service as a Tide Water director none of his partners requested that he do anything to further the interest of Lehman Brothers (R. 53a), and he had no discussions with them concerning Tide Water's affairs or operations (R. 34a, 56a, 150a).

On the basis of these facts, the District Court found that the invitation to Thomas to join the Tide Water board was upon the initiative of Tide Water and that Thomas accepted the directorship because of his interest in the oil business and because of the prestige factor involved in serving on the board of a large corporation (R. 150a). The Court of Appeals concurred in the finding that Lehman Brothers took no action to cause Thomas to be made a director and that the invitation to Thomas came from Tide Water (R. 176, 179, 180). The District Court also found as a fact that Thomas had not been deputed to represent

the interests of Lehman Brothers on the Tide Water board (R. 153a). The Court of Appeals concurred in this finding of fact:

> ". . . the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water. Doubtless the firm was pleased to have Thomas succeed Hertz as a director, and so was John Schiff, of Kuhn, Loeb & Company, who introduced his friend Thomas to David T. Staples, president of Tide Water who thereafter invited Thomas to become a director. *However, there is no evidence of any deputizing or other affirmative action by the firm to cause Thomas to be made a director to protect the interests of the firm or to become its representative.*" (R. 179; emphasis supplied)

In an article published in the *Wall Street Journal* on September 17, 1954, Tide Water announced that it was considering a proposal to allow shareholders to exchange common stock for a new dividend-paying-preferred stock (Defendants' Exhibit "A"; 162a, 75a). On October 8, 1954 a second article appeared in the *Wall Street Journal,* which announced that the Tide Water Board of Directors had approved a plan of recapitalization creating an issue of $1.20 dividend cumulative preferred stock, and providing that holders of Tide Water common stock could exchange their common stock on a share for share basis for such preferred stock (Defendants' Exhibit "B"; 163a, 75a, 176, 177).

On October 8, 1954, after publication of the second article, Messrs. Hammerslough and Glazier, members of the investment committee of Lehman Brothers, met with Mr. Herman Kahn, also a partner of Lehman Brothers, and determined to purchased 50,000 shares of Tide Water common stock because the "preferred stock into which the

common stock was going to be exchanged subject to the approval [of the Tide Water shareholders] would be a very, very safe, good investment, and would be attractive, once it was issued, to institutional investors throughout the country." (71a, 83a-85a, 177).

Between October 8, 1954 and November 15, 1954 Lehman Brothers purchased in the regular course of its business 50,000 shares of Tide Water common stock at an aggregate cost of $1,330,800 (150a, 169a).

As soon as Thomas learned of the firm's first acquisition of Tide Water's common stock he completely disassociated himself from the transaction and from the firm's activities with respect thereto (R. 122a, 123a). He immediately instructed the firm's controller to exclude him (Thomas) "from any risk of the purchase or any profit or loss from the subsequent sale and to take the necessary steps to carry out my [Thomas'] instructions" (R. 122a). None of Thomas' capital in the firm was at risk (R. 122a, 123a) and he did not share in any of the profits realized from the transactions (R. 123a, 116-120a; Defendants' Exhibit "C", 165a, 142a; Defendants' Exhibit "D", 167a, 142a). In addition, at the next partners meeting, held on the following Monday, he told his partners that he wanted them all to know that he was not a part of Tide Water transaction and that he excluded himself from any profits or losses (R. 123a). They agreed (R. 123a).

On December 8, 1954, pursuant to the plan of recapitalization, Lehman Brothers exchanged its 50,000 shares of Tide Water common stock for 50,000 shares of a new preferred stock (R. 151a). Between December 9, 1954 and March 8, 1955 Lehman Brothers sold its 50,000 shares of preferred stock realizing in the aggregate the sum of $1,361,186.77 (151a, Defendants' Exhibit "E", 169a, 126a). On an investment of approximately one and one-

third million dollars Lehman Brothers realized a profit of $30,386.77.*

Mr. Thomas testified that he had not talked with any of his partners with respect to Lehman Brothers' purchase of Tide Water common stock (R. 45a, 56a, 57a, 139a, 151a, 177). All the witnesses with knowledge of the subject testified that Thomas did not speak with them concerning the investment in Tide Water and, to their knowledge, did not speak with anyone in Lehman Brothers concerning it (R. 67a, 71a, 80a, 85a, 137a). In the face of this testimony, petitioner, himself, conceded that none of the respondents spoke to Mr. Thomas concerning the proposed change in Tide Water's capital structure (R. 146a).

The District Court found as a fact that Thomas was not consulted by his partners as to the issuance of the new Tide Water stock and that it was bought and sold by Lehman Brothers without any advice or concurrence of Thomas (R. 150a). The Court of Appeals concurred in this finding of fact (R. 177, 181).

Both the District Court and the Court of Appeals found as a fact that Lehman Brothers' purchases of Tide Water common stock were made solely on the basis of information found in the two articles published in the *Wall Street Journal* and not on the basis of confidential information (R. 150a, 176-77). While Thomas testified that he stated to his partners and to others that he thought well of the

*The profit of $30,386.77 is the excess of the price received on the sale of the preferred stock over the cost of the common stock. The District Court, however, in determining the amount for which Thomas was accountable, found that the cost of the preferred stock was the lowest price at which the common stock sold on December 8, 1954, the date of exchange. Since that price was lower than the actual cost (to Lehman Brothers) of the common stock, the District Court's determination that the total profit was $98.686.77 was based on a theoretical purchase of preferred stock on the day of the exchange of common stock for preferred stock and did not reflect the actual dollar results of the transactions.

management of Tide Water, the Court of Appeals noted that Thomas' statements were "a far cry from the giving of confidential information" concerning the Tide Water issuance of common stock and exchange offer (R. 181).

Both the District Court and the Court of Appeals concurred in findings of fact that Thomas had disassociated himself from the transaction and received no part of the profits (R. 152a, 177, 185). The District Court, held, however, that Thomas' waiver to his partners did not prevent him from "realizing" what would have been his proportionate share of the firm's profits. Relying upon *Helvering* v. *Horst,* 311 U. S. 112 (1940), a tax case adopting a similar approach, the District Court stated that "by making such transfer of profits he [Thomas] was disposing of profits and to that extent he 'realized' the profits" (R. 155a). The Court of Appeals agreed with this holding.

Summary of Argument

Section 16(b) of the Securities Exchange Act of 1934 requires only three specified classes of persons to account to a corporate issuer for "short-swing" profits realized by them, namely (1) directors, (2) officers, and (3) holders of 10% of any class of any equity security of an issuer. The firm of Lehman Brothers is neither a director, officer or 10% stockholder, and under the plain words of Section 16(b) other classes of persons are not accountable.

The clear meaning of the words of Section 16(b) is buttressed by a legislative history which establishes that Congress did not intend that anyone, other than those specified in the Act, would be accountable to a corporate issuer for "short swing" profits realized by them. In its consideration of the bills which ultimately became the Act,

Congress was presented with questions similar to those now confronting this Court.

Drafts of Section 16(b) submitted to Congress would have made it unlawful for an insider to disclose confidential information and would have imposed an obligation to account for "short-swing" profits upon any person to whom unlawful disclosure was made. Congress advisedly deleted both of these provisions from Section 16(b) and it thus specifically considered and refused to provide a right of recovery to corporations for "short-swing" profits realized by third parties who received or had access to confidential information through insiders. The legislative intent is clearly demonstrated by the history and the words chosen by Congress; it cannot be ignored in favor of a different policy, no matter how "logical" it is claimed to be.

For this reason, the Second Circuit in *Rattner* v. *Lehman Brothers,* 193 F. 2d 564 (2d Cir. 1952) held, under circumstances identical to the case at bar, that neither the partners of a director nor the director himself are obligated to account for "short-swing" profits realized by the non-director partners. The court found that "the legislative history indicates that the omission of any provision for such liability [the accountability of a director's partners for profits realized by them] was intentional" (193 F. 2d at 566).

Neither the Securities and Exchange Commission, prior to this case, nor Congress, at any time, has ever raised any objections to the *Rattner* rule, laid down in 1952, or ever given any indication that it could not be relied upon. To the contrary, in connection with an amendment to a Commission rule which required a partner-director to report all changes in the beneficial ownership of equity securities held by his partnership, the Commission specifically stated that the amended rule was "not intended as a modification of the principles governing liability for shortswing

transactions under Section 16(b) as set forth in the case of *Rattner* v. *Lehman*. . . ." And the Commission has never chosen to exercise its power under Section 23(b) of the Act to recommend legislation to Congress which would eliminate the disastrous consequences now allegedly resulting from the *Rattner* rule. Thus, for a period of nearly thirty years, the Commission has not sought to impose liability upon a person who is not a member of the three groups specified in the statute, whether he be a relative, spouse, friend, partner, or other business associate of an insider.

It is not a proper judicial function to expand the scope of a provision carefully limited by Congress, particularly when that provision, based upon a series of legislative findings and resultant conclusive presumptions, imposes an absolute liability. Lehman Brothers could be held accountable under Section 16(b), therefore, only if it were a director, officer or 10% stockholder of Tide Water. There is no claim that Lehman Brothers was within either of these latter two categories. Furthermore, it was not a "director" as that term was defined by Congress. The term director, as used in Section 16(b) of the Act, is specifically defined in Section 3(a)(7) to mean a person performing the functions of a director for an issuer. Lehman Brothers never performed any director functions for Tide Water. Lehman Brothers did not appoint or have the power to appoint Thomas to the Tide Water Board nor did Thomas represent Lehman Brothers on the Tide Water Board. Both courts below have concurred in findings to this effect; since those findings are adequately supported they should not be disturbed.

Thus, the allegations of deputation and representation not only were unproved in the courts below but they are concepts without relevance to liability under the Act. Had Congress intended to include the concept of directorship by deputation in Section 16(b), or to treat partners of directors

as directors, it could have and would have said so. For example, Section 17 of the Public Utility Holding Company Act of 1935 provides that no registered holding company shall have as a director any partner of an investment banker. Similarly, Sections 30(f) and 2(a)(3)(D) of the Investment Company Act of 1940 impose the obligations of Section 16(b) of the Securities Exchange Act of 1934 upon partners of an investment adviser.

Respondent Thomas is not obligated to account for more than his own pro rata share of the profits realized by the firm. Section 16(b) imposes liability upon a director only for "any profit realized by him". The legislative history demonstrates that Congress was perfectly aware that Section 16(b) did not reach profits realized by non-insiders, and it deliberately refrained not only from making an insider answerable for such profits but from making it unlawful for an insider to disclose confidential information to third parties.

Thomas at no time was entitled to nor did he share in or exercise any control over the profits received by the other members of Lehman Brothers. Thomas was not a co-owner of Tide Water securities when purchased, but even if he were, such fact could not create liability in Thomas for profits realized by his partners since co-ownership of partnership property cannot be equated with co-realization of partnership profits. Partnership law is clear that Thomas did not have an indivisible interest in the profits of the firm and that his only interest in the profits resulting from the Tide Water transaction was his 4% share, as provided in the partnership agreement.

The judgment rendered against Thomas for what would have been his pro-rata share of the firm's profits had he received it was based on the premise that Thomas could not transfer to his partners his share of the profits without exercising such dominion over those profits that

he "realized" them within the meaning of Section 16(b). It is moreover, undisputed that as a result of this disassociation of himself from the transactions Thomas never received even his purported share of such profits. To award interest on the judgment against him would be penal and inequitable.

ARGUMENT

I

THE FINDINGS OF FACT BY THE TWO COURTS BELOW ARE ADEQUATELY SUPPORTED AND SHOULD NOT BE DISTURBED.

Petitioner continues to rely here on the two factual premises which he repeatedly asserted at trial formed the cornerstone of his case, namely, (1) that Thomas disclosed confidential information concerning Tide Water to his partners and (2) that Thomas was deputized by Lehman Brothers to protect its interests and to represent it on the Board of Directors of Tide Water. The District Court and the Court of Appeals found that Thomas did not disclose any confidential information to any of his partners and that Lehman Brothers' purchases of Tide Water common stock were made solely on the basis of public information found in two articles published in the *Wall Street Journal*. Moreover, both courts below found as a fact that the invitation to Thomas to become a member of the Tide Water board emanated from Tide Water and that Lehman Brothers neither took any action to cause Thomas to be made a director nor deputized Thomas to represent its interests on the Tide Water board.

Under familiar rules, none of these findings should now be disturbed or disregarded unless clear error is shown.

United States v. *Real Estate Boards*, 339 U. S. 485, 495-96 (1950); *Virginia Ry.* v. *System Federation*, 300 U. S. 515, 542 (1937); *United States* v. *Yellow Cab Co.*, 338 U. S. 338 (1949); *Texas & N. O. R. Co.* v. *Railway Clerks*, 281 U. S. 548, 558-560 (1930); Robertson & Kirkham, *Jurisdiction of the Supreme Court of the United States* (Wolfson & Kurland ed. 1951) pp. 657-61. Petitioner makes no attempt to demonstrate that the findings of the courts below are not based upon substantial evidence in the record; indeed, petitioner's brief avoids all findings of fact and by various citations to testimony out of context and by inaccurate quotation (Compare Pet. Brief, pp. 4-6 with R. 60a-67a) he urges this Gourt to draw inferences at variance with those drawn by the courts below. And the Commission, while recognizing that this Court will not review the facts as found by the lower courts, requests this Court to draw its own "conclusions" from the basic facts, particularly with respect to whether Thomas was deputed by Lehman Brothers to represent its interest on the Tide Water board (SEC Brief, p. 12, fn. 5). The "two-court rule," however, applies not only to the findings of facts of two lower courts but also to all inferences which they reasonably drew from such basic facts. See, e.g., *Graham & Co.* v. *Locomotive Firemen and Enginemen*, 338 U. S. 232, 235 (1949); *United States* v. *Dickinson*, 331 U. S. 745, 749 (1947); *United States* v. *Commercial Credit Co.*, 286 U. S. 63, 67 (1932); Robertson & Kirkham, *supra*, at p. 661. Not only were the inferences drawn by both courts below reasonable, but there is no evidence from which other inferences could have been drawn. Petitioner in effect asks this Court to retry *de novo* both the issue of whether Lehman Brothers used confidential information and also the issue of the design, motive and intent relating to Thomas' election to and service on the Tide Water board. But consistently this

Court has properly refused to perform such a function. As the Court said in *United States v. Yellow Cab Co., supra,* at p. 341:

> "Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them. If defendants' witnesses spoke the truth, the findings are admittedly justified. . . . There is no exception which permits it [the Government], even in an anti-trust case, to come to this Court for what virtually amounts to a trial *de novo* on the record of such findings as intent, motive and design. While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have in any case where the evidence would support a conclusion either way but where the trial court has decided it to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous.' "

II

SECTION 16(b) DOES NOT REQUIRE THE FIRM OF LEHMAN BROTHERS TO ACCOUNT TO TIDE WATER FOR PROFITS REALIZED BY ITS NON-DIRECTOR PARTNERS ON THE SALE OF TIDE WATER STOCK.

A. The plain language of Section 16(b) and its legislative history clearly establish that partners of a director are not required to account for "short-swing" profits which they realize.

Section 16(b) imposes an obligation to account only upon three specific classes of persons, to wit, officers, directors and beneficial owners of 10% of any class of

any equity security of an issuer. The words used by Congress leave no room for the imposition of such an obligation upon other classes of persons. As this Court noted in *United States* v. *Great Northern Ry.*, 343 U. S. 562, 575 (1952), it is the "judicial function to apply statutes on the basis of what Congress has written, not what Congress might have written." Resort to general legislative purpose is unnecessary when, as in Section 16(b), the meaning of the words chosen by Congress leave no room for reasonable doubt *Ex Parte Collett*, 337 U. S. 55, 61 (1949); *Packard Co.* v. *N. L. R. B.*, 330 U. S. 485, 492 (1947). But if such resort is made, the legislative history of Section 16(b) establishes that Congress purposely limited liability to officers, directors and 10% shareholders.

Congress enacted Section 16(b) to curb abuses in the trading in securities of an issuer by certain persons who, because of their relationship to that issuer, had access to confidential information. To eradicate such abuses, Congress designated certain classes of persons "insiders" and required them to account for all short-swing profits realized by them, establishing a conclusive presumption that purchases and sales made within a six months period were made on the basis of confidential information. The persons so designated as "insiders" by Congress, namely, directors, officers and 10% stockholders, were those who, because of their relationship to issuers, it could be presumed have access to and act upon the basis of confidential information. Of course, it was argued to Congress that "short-swing" profits can also be realized by persons with no special relationship to an issuer but who, nevertheless, have access to confidential information as a result of their relationship to a particular insider. Hence, Congress was necessarily presented with the question raised in this Court—should a corporation be allowed to recover "short-swing" prof-

its realized by persons other than directors, officers and 10% stockholders who, because of their particular relationship to an insider, actually receive confidential information or who, because of their relationship to insiders, whether it be through marriage, friendship, partnership or other business association, might be presumed to have access to and use such information. Recovery of profits realized by such other persons could logically have been allowed against the insider or against the third party or against both such parties. Congress consciously rejected all three of these alternatives.

Early drafts (H. R. 7852, 73d Cong., 2d Sess. § 15(b), S. 2693, 73d Cong., 2d Sess. § 15(b)) of the provisions which eventually became Section 16(b) provided:

> "(b) *It shall be unlawful for any director,* officer, or owner of securities, owning as of record and/or beneficially more than 5 percentum of any class of stock of any issuer, any security of which is registered on a national securities exchange * * * *(3) To disclose, directly or indirectly, any confidential information regarding or affecting such registered security* not necessary or proper to be disclosed as a part of his corporate duties. *Any profit made by any person, to whom such unlawful disclosure shall have been made,* in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure *shall inure to and be recoverable by the issuer* unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties . . ." (Emphasis supplied)

The reasons underlying inclusion of subsection (3) were clear. Both the draftsman of the Act and the Con-

gressional Committees which held hearings* on the Act, understood that the chosen definition of corporate insiders did not include all persons who might realize short-swing profits through the use of confidential information and that subsection (3) was necessary in order to make non-insider recipients of confidential information, whether they be wives, children, friends, partners or business associates of insiders, accountable to a corporation for the "short-swing" profits they realized. Thus, the following colloquy took place between members of the Senate Committee on banking and currency and Mr. Corcoran, chief spokesman for the draftsmen and proponents of the Act:**

> "Senator Gore: Would this [present Section 16(b)] prevent him [a corporate fiduciary as defined in the Act] from confederating with someone else, if he were willing to forfeit the profit? His friends on the outside would take the profit resulting from the influences he exercised on the market and then split the pot with him.
>
> Mr. Corcoran: There is an attempt in the next section [15(b) (3)] to catch that?
>
> Senator Carey: Would it be possible for a man to have several people purchase this stock for him?
>
> Mr. Corcoran: There are provisions later to catch his wife and children, as well as trustees for him. There is also a provision in the next section to catch those whom he tips off, and who probably buy

*Extensive hearings resulting in testimony and documents of over 10,000 pages preceded the enactment of the Securities Exchange Act of 1934. Five separate bills were introduced, H. R. 7855, H. R. 9323, H. R. 7852, H. R. 8720, S. 2693 and public hearings were held on the latter three over a period of two years. See Hearings before Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess., and S. Res. 56 and S. Res. 97, 73d Cong., 1st and 2d Sess., 1934 Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess., 1934.

**He was so described by the Second Circuit in its opinion in *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (2d Cir.), *cert. denied,* 320 U. S. 751 (1943).

for his account, and split the profit, insofar as they can be caught."*

Mr. Corcoran's explanation of the need for subsection (3) before the House Committee on Interstate and Foreign Commerce is even more illuminating:

> "Now, on page 29, subsection (3), an insider tips off somebody with his inside information, somebody to whom he makes an unlawful disclosure of the secret condition of the company, and the person tipped makes a short swing profit on the stock. The company can sue him for cooperating with the director or with the officer or the stockholder for participating in the profits of the company. That is, the director cannot evade having to turn over his own profit under section 15 by tipping off somebody else to do the job for him, nor can he tip off a friend, or friends, and let them make a killing on inside information at the expense of other people."**

With this Congressional understanding of the need for and purpose of subsection (3), it was deleted from the bills which eventually passed both the House and Senate and which became the Securities Exchange Act of 1934.*** As petitioner admits, Congress intentionally omitted this pro-

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*Hearings before the Committee on Banking and Currency on S. Res. 84, 72d Cong., 2d Sess., and S. Res. 56 and S. Res. 97, 73d Cong., 1st and 2d Sess., 6558 (1934).

**Hearings before Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess., 135 (1934).

***The care with which Congress considered the kind of inhibitions to impose on short-swing transactions is demonstrated by the events preceding the passage of the Act in the House. After extensive hearings on H. R. 7852, a new bill was presented to the House Committee on Interstate and Foreign Commerce by Representative Rayburn (H. R. 8720) in order to meet certain criticisms which had been directed at H. R. 7852 during the course of the hearings (*Hearings,* id. at 625). The new bill, *inter alia,* eliminated subsection (3) from H. R. 7852. The bill which was ultimately passed by the House (H. R. 9323) failed to penalize short-swing transactions at all, other

vision because of its dubious administrative practicality.*

It is therefore plain that Congress specifically considered and refused a right of recovery to corporate issuers for those "short-swing" profits realized either by third parties to whom insiders actually disclosed confidential information or by third parties who might have special access to confidential information by reason of their particular relationship to insiders. There is no room for speculation as to Congressional intent in the context of the instant case; indeed, it appears obvious that petitioner is requesting this Court to extend the statute to provide what Congress explicitly considered and rejected. "In our anxiety to effectu-

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than "short sales", and it was only after the Conference Committee agreed to the Senate version of the bill that the House agreed to the penalties now set forth in Section 16(b). See Conference Report Accompanying H. R. 9323, H. R. Rep. No. 1838, 73d Cong., 2d Sess. 35 (1934).

*The following colloquy, which took place during the course of the House hearings, is only one of many which indicates the Congressional dissatisfaction with enacting a provision, the enforcement of which was impractical:

> "Mr. Wolverton: . . . [H]ow are you going to catch anybody?
>
> * * *
>
> Mr. Corcoran: Sir, in the great majority of cases in which that occurs, you are never going to find it out, but is it not worth while to get those cases where you can find it out, you want to catch them even if you cannot catch all of them.
>
> Mr. Wolverton: But, with this bill before us in an effort to regulate the stock exchanges, and eliminate certain evils, I would like for you to give us an example as to how it is to be done. I am interested in the practical side of it and not the theoretical side. I am not in favor of just putting words into a bill without giving serious consideration to their effectiveness.
>
> Mr. Corcoran: You will catch a few of them, and the fact that the risk of being caught, even if that is only a small risk, will act as a deterrent in a great many cases.
>
> Mr. Wolverton: It would seem to require considerable optimism to expect this provision in the bill to be more effective

ate the congressional purpose of protecting the public, we must take care not to extend the scope of the statute beyond the point where Congress indicated it would stop." *62 Cases of Jam* v. *United States,* 340 U. S. 590, 593, 600 (1951). Petitioner's continued reference to the general purpose of the statute is irrelevant since Congress has manifested a considered legislative judgment upon the question presented here. See *Fourco Glass Co.* v. *Transmirra Prods. Corp.,* 353 U. S. 222, 228 (1959); *MacEvoy* v. *United States,* 322 U. S. 102, 107 (1944); *Ginsberg & Sons, Inc.* v. *Popkin,* 285 U. S. 204, 208 (1932).

This view of the legislative history of Section 16(b) has not only been confirmed by both courts below in this case but by every other court which had occasion to consider it. See e.g., *Smolowe* v. *Delendo Corp.,* 136 F. 2d 231 (2d Cir.) *cert. denied,* 320 U. S. 751 (1943); *Rattner* v. *Lehman Brothers,* 193 F. 2d 564 (2d Cir. 1952).

In *Smolowe* v. *Delendo Corp., supra,* Judge Clark stated:

> "Furthermore, provisions in these early drafts declaring unlawful the improper disclosure of confidential information regarding securities by directors, officers, or principal stockholders, and holding

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than the Prohibition Enforcement Act. Do you have such optimism?

Mr. Corcoran: Yes; I suppose I have.

Mr. Wolverton: Well, that act has certainly shown the utter futility of attempting to enforce a provision of this kind. It seems to me that this provision might be even more difficult.

* * *

Mr. Corcoran: No. Suppose a man is very close to the inside of a corporation, and there is circumstantial evidence turning up, for instance, in tax returns, or otherwise that he did buy stock just before a lift and sold out within 6 months, and that he was very, very close to a certain officer, or director of the company. That might be enough to prove a case against him.

Mr. Wolverton: My optimism is not as good as yours."

(Hearing before the Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73d Cong., 2d Sess. pp. 135-138 (1934)).

that any profit made by any person to whom such unlawful disclosure was made should inure to the corporate issuer, were deleted, presumably because the burden of proof made enforcement unfeasible." (136 F. 2d at 236).

The Court of Appeals for the Second Circuit held in circumstances identical to those here present, that Section 16(b) does not require a partnership to account for the "short-swing" profits realized by it from trading in the equity securities of an issuer merely because one of the firm members was a director of the issuer. *Rattner* v. *Lehman*, *supra*. The court in that case rested its opinion squarely upon the ground that "the legislative history indicates that the omission of any provision for such liability [the accountability of a director's partners for profits realized by them] was intentional" (193 F. 2d at 566), while noting that a "literal" reading of Section 16(b) required the same result.

Following the decision in *Rattner* the Securities and Exchange Commission amended its Rule X-16A-3, which is one of the regulations implementing the reporting requirements of Section 16(a). Until November 1, 1952 the rule required a partner-director to report only that amount of the equity securities of his corporation held by his partnership which represented his proportionate interest in the partnership. As amended November 1, 1952 the rule required a partner-director thereafter to report the entire amount of the equity securities held by the partnership but it gave him the option ". . . if he so elects, [to] disclose the extent of his interest in the partnership . . ." Securities and Exchange Commission Release No. 4754 (September 24, 1952),* explains the purpose of the amendment in the following language:

"... The new rule X-16A-3 requires any person who is a member of a partnership which owns securities of an issuer of which he is an officer, director, or ten per cent stockholder to report all holdings and all changes in the beneficial ownership of equity securities of that issuer held by the partnership. *It is not intended as a modification of the principles governing liability for short-swing transactions under section 16(b) as set forth in the case of Rattner* v. *Lehman*, 193 F. 2d 564. . . ." (Emphasis supplied)

The Commission, which is primarily responsible for administering the Act and, under Section 23(b) of the Act, for recommending remedial legislation, specifically informed Congress of the holding of the *Rattner* case in its Seventeenth and in its Eighteenth Annual Reports to Congress. *Seventeenth Annual Report of the Securities and Exchange Commission*, p. 62 (1952); *Eighteenth Annual Report of the Securities and Exchange Commission*, p. 79 (1953). In neither of these reports nor in any subsequent ones did the Commission ever voice any dissatisfaction with the *Rattner* opinion or recommend legislation to cure defects resulting from the Second Circuit's interpretation of Section 16(b). Not until the present time has the Commission indicated any doubts as to the correctness of the interpretation of Section 16(b) contained in *Rattner*. During a period of nearly thirty years since the passage of the Act, it has not sought to impose liability upon third party recipients, or potential recipients, of inside information, whether they be relatives, partners, or business associates of an insider. See *United States* v. *Leslie Salt Co.*, 350 U. S. 383, 396 (1956); *FTC* v. *Bunte Bros., Inc.*, 312 U. S. 349, 351-52 (1941).

the results of the *Rattner* litigation, Congress failed to take any action to remedy the alleged consequences of the *Rattner* result. This in itself is persuasive evidence that both *Rattner* and the identical result below were in accordance with Congressional intent. *Toolson* v. *New York Yankees, Inc.*, 346 U. S. 356 (1953); *United States* v. *Elgin, J. & E. Ry.*, 298 U. S. 492, 500 (1936).

Neither *Rattner* nor the decision below carve out an exception to a uniform judicial interpretation of Section 16(b) as "broadly remedial". The cases relied upon by petitioner (Pet. Brief, p. 17-19) merely hold that the remedial purpose of Section 16(b) is broad enough to strike down any means by which *admitted insiders* realize "short-swing" profits; they did not deal with the question of whether or not a particular person was an insider. Since it has been consistently recognized that Congress deliberately limited Section 16(b), it is not respondents but petitioner who would have this Court carve out an arbitrary exception to a long recognized and accepted interpretation of Section 16(b).

Nor did *Rattner* or the decision below carve out an exception to the rule that liability under Section 16(b) does not require a showing of an actual use of inside information. While it is true that both courts below found that Thomas did not disclose any confidential information and that the purchase and sale were made by Lehman Brothers without the advice or concurrence of Thomas, they specifically held, as did Rattner, that partners of a director are not accountable for profits they realize whether or not there was disclosure of confidential information.

In construing Section 16(b) it must be remembered that the section is woven from a delicate fabric of presumptions. The constitutionality of the imposition of an absolute liability upon Congressionally designated insiders has been sustained on several occasions primarily on the ground that

there were Congressional findings that the persons within the specified classes normally do have access to confidential information and do act on the basis of such information. Thus the imposition of an absolute liability on such persons was held to be a reasonable remedial solution. *Smolowe* v. *Delendo Corp., supra.* Now to argue, in the absence of comparable legislative findings, that this absolute liability should be extended to other persons, would pose serious constitutional questions. Cf. *Tot* v. *United States,* 319 U. S. 463 (1943).

Petitioner suggests no rational formula for determining what additional categories of persons should be held accountable for "short-swing" profits by reason of their relationship to "insiders". There is some suggestion in the brief of the Commission that it would limit such accountability to partners of a director, but only when the partnership is engaged in the business of investment banking.* No reason or statutory basis for the extension of the statute to this limited group is suggested.

For one thing, the principals of an investment banking concern which does business in the corporate form have the same access to confidential information if one of them serves as a director of an issuer as does a partnership where one of the partners is a director of an issuer. For another, the possibility of mutual exchange of confidential information is just as possible if the partnership were engaged in the practice of law, accounting, or engineering, since the partners in these firms are in frequent contact and obviously share common business interests. As a matter of fact, accessibility to confidential information exists just as often, or

*At page 12 of its brief (footnote 4) the Commission states that investment banking firms are "customarily organized as partnerships". A perusal of the list of defendants in *United States* v. *Morgan,* 118 F. Supp. 621, 625-6 (S. D. N. Y. 1953), reveals that seven of the seventeen leading investment banking firms were organized as corporations.

more often, where a relationship between an insider and a third party results from marriage, consanguinity or friendship. It is clear, therefore, that whatever access a partnership may have to confidential information because one of the partners is an insider is unrelated both to the activities in which the partnership is engaged and to the choice of the partnership form of organization rather than some other form of business entity.

No matter how put, petitioner's argument is no more than that this Court should judicially impose liability upon certain groups of potential recipients of confidential information because of their relationship, not to an issuer, clearly the standard followed by Congress, but because of their relationship to an insider. That Congress purposely limited the remedial scope of Section 16(b) so as to include "short-swing" profits realized only by those persons specified in that section clearly emerges both from the plain meaning of the words chosen and the legislative history. The Congressional mandate does not permit the roaming at large urged by petitioner.

B. Lehman Brothers Was Not a Director of Tide Water

Statutory liability under Section 16(b) can be imposed only on persons designated as insiders by that section. Petitioner has attempted to conform to this legislative reality at one place in his brief by characterizing the entire firm of Lehman Brothers as a director of Tide Water (Pet. Brief pp. 34-35). Apparently it was Lehman Brothers' "access to confidential information" (Pet. Brief p. 35) that elevated it to directorship status. But this argument is based on the very same ground as petitioner's attempt to have this Court disregard the clear legislative history of Section 16(b) and to extend its scope to reach individuals or categories of individuals not enumerated in the Act solely because of the alleged use of, or access to, confidential information.

A partnership is defined as a "person" in Section 3 (a)(9) of the Act. The relevant question, however, is whether such a person is a director. Congress defined the term director in Section 3(a)(7) of the statute to mean:

> ". . . any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated. (15 U. S. C. § 78c(a)(7))

A *sine qua non* of directorship status under Section 16(b) is, therefore, that the alleged director is actually performing the functions of a director for the issuer.

The requirement that duties be performed is identical to a similar requirement in the Commission's Rule 3b-2 which defines officer as:

> ". . . any other person *who performs for an issuer,* whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers." (Emphasis added)

This similarity is noted in *Lockheed Aircraft Corp.* v. *Rathman,* 106 F. Supp. 810, 813 (S. D. Cal. 1952), and in 2 Loss, *Securities Regulation* 1095 (2d ed. 1961). Petitioner has misinterpreted the statements of the court in the only case cited by him to support the proposition that Lehman Brothers was itself a director because of its possible access to information. In ascertaining whether an employee was an "officer" for the purpose of Section 16(b), the court, in *Colby* v. *Klune,* 178 F. 2d 872 (2d Cir. 1949), although expanding the definition of officer beyond that contained in commission Rule 3b-2, indicated that it is essential that the employee perform important executive duties before he can be deemed an officer under the statute:

> ". . . we construe 'officer,' as used in Section 16(b) of the Securities Exchange Act, thus: It includes,

> *inter alia,* a corporate employee performing important executive duties of such character that he would be likely, in discharging these duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions. It is immaterial how his functions are labelled or how defined in the by-laws, or that he does or does not act under the supervision of some other corporate representative." (178 F. 2d at 873; footnotes omitted).

Thus, access to confidential information in itself is not enough, even under *Colby* v. *Klune,* to constitute a person an officer. The Commission has rejected the relevance of access to confidential information in determining officership status, because such an approach would lead to "undue uncertainties", and the SEC continues to utilize the purely functional approach embodied in Rule 3b-2. Securities Exchange Act of 1934, Release No. 4754 (September 24, 1952).

The record of this case does not contain a scintilla of evidence nor does petitioner now suggest that Lehman Brothers, or any of its partners other than Thomas, ever performed any director functions for Tide Water or, indeed, ever performed any services for Tide Water at all except in their capacity as investment bankers. Unable to meet the evidentiary requirements of Section 3(a)(7), petitioner argues that Lehman Brothers is a director because of some alleged representation by Thomas. Petitioner has not explained how "representation"—even if proved—can be equated with the statutory requirement that directors' functions be performed.

Perhaps in a situation where a "dummy" director represents shareholders and casts votes which represent the group's view, then it could be argued that the real owners are, through this "deputation", performing the function

of a director. In such a case it would, of course, seem to be necessary to show that those represented actually made the decisions on various subjects, which were carried out by the ostensible director. There is no evidence in the record that Thomas was a "dummy" director, or that Lehman Brothers dictated to Thomas as a director; and the findings of fact so state. Petitioner did not even attempt to introduce evidence that would indicate that Thomas consulted his partners before casting votes as a director or that Lehman Brothers in any way attempted to influence his vote. Thomas' uncontroverted testimony was that he would have considered it highly improper to consult the Lehman Brothers partners on Tide Water matters being considered by the latter's Board of Directors (R. 34a, 56a). As was stated in *Gilman* v. *Jack,* 148 Me. 171, 91 A. 2d 207 (1952), a case refusing to hold a director a "representative" of certain investment bankers for purposes of the Public Utility Holding Company Act, 15 U. S. C. § 799(c):

> "There is no evidence that he owed any express or implied duty to them to support or carry out their views. Nor is there any evidence that he was not to exercise his own independent judgment as to what would be for the best interests of the corporation in any of his acts as director thereof. On the other hand, the right of entire freedom of action on his part, as such director, is clearly established. Under such conditions the sitting justice properly found as as matter of law that he was not an appointee or representative of investment bankers within the meaning of section 17(c), supra." (91 A. 2d at 208-209).

Petitioner argues that Thomas represented (a term not appearing in Section 16) Lehman Brothers because he might have been instrumental in obtaining some underwriting business for that firm. The fact of the matter is that Lehman Brothers obtained no financial business from Tide

Water during Thomas' tenure on the board prior to the institution of this action (R. 17a, 1a). Moreover, there is no proof in the record that Lehman Brothers' participation in the underwriting group in the 1956 Tide Water offering of securities (R. 17a) resulted from Thomas' directorship.

Even had petitioner been able to prove that Thomas' presence on the board had helped Lehman Brothers maintain cordial relations with Tide Water, there is no logical nexus between cordial relations and the imposition of Section 16(b) liability.

Unable to meet the statutory requirement that he prove that Lehman Brothers performed the functions of a director, and unable to prove that Thomas represented Lehman Brothers on the Tide Water Board, petitioner points to a comment in a concurring opinion by Judge Learned Hand in the *Rattner* case. In that opinion Judge Hand said:

> "* * * and the only question is whether partners are liable for whatever profits the firm may make, whenever one of their members is a director, and only because he is a director. I agree that § 16(b) does not go so far; but I wish to say nothing as to whether, if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable. True, they would not even then be formally 'directors'; but I am not prepared to say that they could not be so considered; for some purposes the common law does treat a firm as a jural person. The provision eliminated from the earlier drafts of the Act does not seem to me to throw any light at all on such a situation as that." (193 F. 2d at 566-67).

Petitioner has not explained how a deputor's liability fits into the statutory scheme of Section 16(b). The Commission would eliminate the obscurity of the deputing concept with its assertion that there need be no "formal deputization" and therefore no need to prove that a "partner was

installed as a director to aid his partnership or that he transmitted inside information to his associates." [SEC Brief, p. 18] Thus, the Commission would eliminate the "if" clause from Judge Hand's comment and would distort it to reach the very result that he explicitly rejected—that the fact of partnership alone constitutes a basis for Section 16(b) liability.

It is apparently petitioner's position that the word "deputing" relates to the partnership's role in the selection of a director rather than its and his activities during his tenure of office. Whatever the chronological limits of the word, it should be noted that in this case, the first case where deputing was specifically alleged, Judges Medina and Swan, in the decision below, concluded that they could "not see how any sort of deputizing can make the partners or the partnership a 'director' within the meaning of Section 16(b)" (R. 179).

In this case, the District Court found, and the Court of Appeals agreed, that there was "no evidence of any deputizing" (R. 179) and that "the evidence in this case will not support an inference that Lehman Brothers deputized Thomas to represent its interests as director on the board of Tide Water" (R. 179). The District Court found and the Court of Appeals reiterated that "The invitation to join the Tide Water Board was upon the initiative of Tide Water" (R. 150a, 176, 180). Such invitation was extended to Thomas personally, not to Lehman Brothers. Thomas accepted because of his interest in the oil business and because of the prestige factor in serving on the board of a large corporation (R. 150a). In fact, found the District Court, "the interests of Lehman Brothers in Tide Water at the time Thomas was elected to be a director were minimal" (R. 153a).

Since these findings were concurred in by both courts below, for the reasons stated in Point I, *supra*, they should not be disturbed. Lack of evidence in the record cannot be

cured by reference to circumstances surrounding the election of another director twenty years earlier or the procedure followed in selecting directors of other corporations.* Petitioner's attempt to cure evidentiary deficiencies by citing factual findings from prior cases involving the same defendant but different plaintiffs violates fundamental principles of collateral estoppel and ignores the differences between the statutes involved. Petitioner, for example, places strong reliance on *Lehman* v. *Civil Aeronautics Board,* 209 F. 2d 289 (D. C. Cir. 1953), *cert. denied,* 347 U. S. 916 (1954). But the issue in that case was not whether liability should have been imposed on Lehman Brothers because it was a "director" but whether one partner of Lehman Brothers was required to obtain Civil Aeronautics Board approval to act as a director of a common carrier because he could be considered a "representative" of another partner within the meaning of the Civil Aeronautics Act. The word "representative" does not appear in Section 16 of the Securities Exchange Act of 1934. Its use in the Civil Aeronautics Act, moreover, indicates that Congress knows how to embody the concept of representation in a statute when it so desires.

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*At page 5 of his brief petitioner states that he offered to prove that the election of Thomas to the Tide Water board was the fruition of a pre-conceived plan. The offer of proof consisted of petitioner's notice to admit and the responses thereto.

Lehman Brothers, in response to plaintiff's request for admissions, admitted that members of the firm have from time to time served as directors of various corporations, and that the firm in certain instances acted as underwriter along with others in the issuance of securities of a corporation while a member of the firm served as a director of the issuer. That members of Lehman Brothers have in the past served as corporate directors is by itself, of course, a neutral fact. And even when coupled with the fact that Lehman Brothers has performed financial service for such corporations, these admissions have no probative value because they are susceptible of many inferences, the most probable of which is that Lehman Brothers was chosen to render financial services because it is one of the large, experienced underwriting firms participating in a very large number of underwritings.

When Congress was concerned with remedying insider trading abuses it was perfectly able expressly to extend the statutory proscription to partners. Section 30(f) of the Investment Company Act of 1940 (15 U. S. C. § 80a-29(f)) makes Section 16(b) applicable to a person who is an "officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser" of an investment company.* "Affiliated person is defined in Section 2(a)(3)(D) of the Investment Company Act (15 U. S. C. § 80a-2(a)(3)(D)) as, *inter alia,* "any officer, director, *partner,* copartner or employee of such other person. . . ."** (emphasis added) It would have been simple enough similarly to include partners of named insiders in the Securities Exchange Act of 1934.

A further example is found in § 17(c) of the Public Utility Holding Company Act, 15 U. S. C. § 79q(c). Section 17(b) of that Act (15 U. S. C. 79q(b)), which is vir-

*"(f) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 78p of this title upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities. Aug. 22, 1940, c. 686, Title I, § 30, 54 Stat. 836."

**"(3) 'Affiliated person' of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."

tually identical to Section 16(b) of the 1934 Act, makes no mention of the words partner or representative. Yet, the immediately following section, (Section 17(c), 15 U. S. C. 79q(c)), provides that no registered holding company shall have as an officer or director "any executive officer, director, *partner,* appointee, or representative *of any* bank, trust company, *investment banker* . . ." (emphasis added).* The juxtaposition of Section 17(b) and 17(c) clearly demonstrates that Congress deliberately omitted any reference to partners in the insider trading provisions of both Section 17(b) of the Public Utility Holding Company Act and Section 16(b) of the Securities Exchange Act of 1934.

Petitioner's reliance on the trustees' compensation provisions of the Bankruptcy Act is misplaced. The legislative history of Section 16(b) establishes that Congress considered and rejected the liability here contended for. Unlike Section 16, Section 249 of the Bankruptcy Act** was not a carefully limited departure from prior law but merely a codification of the power already exercised by the courts under their general equitable power over compensation.

> "In the absence of statute, a court has the long established discretion to determine and regulate compensation of those acting in a fiduciary capacity under its direction." *In re Central States Electric Corp.,* 112 F. Supp. 281, 287 (E. D. Va.), *leave to*

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*"(c) After one year from August 26, 1935, *no registered holding company or* any subsidiary company thereof *shall have as an officer or director thereof, any* executive officer, director, *partner, appointee, or representative of any bank, trust company, investment banker,* or banking association or firm, or any executive officer, director, partner, appointee, or representative of any corporation a majority of whose stock, having the unrestricted right to vote for the election of directors, is owned by any bank, trust company, investment banker, or banking association or firm, except in such cases as rules and regulations prescribed by the Commission may permit as not adversely affecting the public interest or the interest of investors or consumers. Aug. 26, 1935, c. 687, Title I, § 17, 49 Stat. 830." (Emphasis supplied)

**11 U. S. C. § 649.

appeal denied, 206 F. 2d 70 (4th Cir.), *cert. denied,* 346 U. S. 899 (1953).

See Senate Report No. 1916 on H. R. 8046, 75th Cong., 3d Sess., 38 (1938). See also, 6 *Collier, Bankruptcy* ¶ 13.18 at p. 4585, (Moore ed. 1947). *Berner* v. *Equitable Office Building Corp.,* 175 F. 2d 218, 219 (2d Cir. 1949). Moreover, Section 249 utilizes more sweeping language than that incorporated in Section 16(b). See *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea,* 266 F. 2d 862, 868 (2d Cir.), *cert. denied,* 361 U. S. 862 (1959); *Nichols* v. *SEC,* 211 F. 2d 412, 417 (2d Cir. 1954).

Similarly inapposite are common law cases based upon proven breaches of fiduciary duty. Common law concepts of liability (which apply only after an actual breach of duty has been adjudicated) are irrelevant in a Section 16 action since that section was specifically designed to obviate the necessity of proving breaches of fiduciary duty. In fact, petitioner specifically asserted that he was not relying on common law liability (R. 28a, 29a, 147a).

In sum, the pertinent question here is not whether it is "reasonable" to treat Lehman Brothers as a director (SEC Brief, pp. 16-17) but whether anything in the Securities Exchange Act of 1934 imposes liability on Lehman Brothers under the circumstances of this case. Actually, the position of both petitioner and the Commission is simply that under their view of public policy the Lehman Brothers' partners ought to be held liable because of a supposed access to confidential information. Since the logical route to achieve this goal is foreclosed because Congress designated the categories of persons who, it could be presumed, act on the basis of confidential information, they have attempted to achieve the same end by expanding the concept of "director" and thus accomplish by indirection what they could not do directly. Petitioner and the Commission are unhappy be-

cause Congress drew a clear though arbitrary line defining the persons who would be subject to Section 16, and they have now turned to the courts to cure Congress' "illogical" position. This attempt to rewrite the statute cannot be accomplished by reference to the niceties of state partnership law or by elaborate description of how investment bankers operated in the 1920's. Furthermore, even where petitioner has attempted to construct legal doctrines which would impose liability without amending the statute he has wholly failed to establish any facts which would support those doctrines. On the law and on the facts the partners of Lehman Brothers cannot be held liable under Section 16.

III

THE COURTS BELOW CORRECTLY HELD THAT THOMAS WAS NOT LIABLE FOR MORE THAN HIS PRO-RATA SHARE OF THE PROFITS.

Section 16(b) of the Act imposes liability upon a director only for "any profit realized by him" from certain specified transactions. The statutory mandate is clear, and the legislative history noted above demonstrates, that Congress was perfectly aware that an insider would not be liable under Section 16(b) for profits realized by third persons to whom he disclosed confidential information (*supra*, pp. 18-20). Yet, Congress not only added no such remedy but specifically deleted a provision from Section 16(b) which would have made it unlawful for insiders to disclose confidential information (*supra*, p. 18). Congress specifically refused to impose the "deterrent" now sought by petitioner.

Thomas was entitled to approximately 4% of the firm's profits under the partnership agreement (R. 123a). The courts below held that he could not waive his 4% interest in the profits of the Tide Water transaction so as to escape

liability to the issuer for that amount under Section 16(b) since by transferring his share of the profits to his partners he exercised such dominion over those profits as to "realize" them within the meaning of the Act (R. 155a, 182). Thomas at no time, however, was entitled to, nor did he share in, nor did he exercise control over the remaining 96% of the profits which belonged to the other members of the firm (R. 111a-121a).

It was apparently the theory of the dissenting judge below, now reiterated by petitioner, that Thomas should be held accountable for all the profits realized by Lehman Brothers because he purportedly was "co-owner with all the other partners of the Tide Water stock when bought and of the profits when sold" (R. 187). Under the Act, however, co-ownership is not the operative event creating liability—under the Act, Thomas can be held accountable only for profits realized by him.* Petitioner has equated "co-ownership" of partnership property with "realization" of partnership profits. This theory is premised on a misunderstanding of the applicable partnership law.

First, Thomas never co-owned the preferred stock, the purchase and sale of which is here in issue, because, prior

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*The dissenting judge below argued that each partner was the co-owner with all the other partners of the Tide Water stock and that each partner should be treated as the owner of all the Tide Water stock. Section 16 of the Act speaks only of "beneficial ownership", a basis of liability not alleged in this case. Moreover, the Commission itself has recognized that a partner "owns" only his proportionate share of the securities of an issuer owned by his partnership. An opinion of the General Counsel of the Commission, appearing in Release No. 79 which was reprinted in Release No. 1965, December 21, 1938, 11 F. R. 10971, states that an individual partner who is not a director is not required to file reports as a 10% holder of the equity securities of an issuer unless his proportionate share of the firm's holdings exceeds 10% or, coupled with his other holdings of the same security, exceeds 10%. And Commission Rule 16a-10 exempts any transaction from the provisions of 16(b) which has been exempted from the reporting requirements of 16(a).

to such acquisition, he and his partners agreed to a modification of the partnership agreement which excluded him from any interest in the stock (R. 122a-123a).* Moreover, even if he were considered the co-owner of such stock, it is perfectly clear that under New York partnership law he was not the owner or the co-owner of the profits realized by other partners of Lehman Brothers. Section 52 of the New York Partnership Law specifically provides that:

> "A partner's interest in the partnership is his share of the profits and surplus . . . ."

Thus, rather than acquiring an "indivisible" interest in all of the profits realized by members of a partnership (Pet. Brief, p. 45), a partner's interest in the firm's profits is his specific share as set by the agreement.* The concept of co-ownership in partnership law has reference only to a partner's interest in the partnership's specific property and not to his share in the profits, and principally serves to place such assets beyond the reach of creditors of the individual partner. See *N. Y. Partnership Law*, § 51(2)(c).

If petitioner's view of New York partnership law as creating in each partner an "indivisible" interest in all the firm's profits were correct, then a creditor of Mr. Thomas could have attached or seized his partners' shares of the firm profits to satisfy Mr. Thomas' debt. Section 915-a of the New York Civil Practice Act, however, makes it clear that Thomas owned only his share of the profits (as opposed to the partnership property) realized by the firm, and thus only his share of the profits is subject to attachment by his creditors:

> "The court which granted the warrant of attachment . . . may . . . appoint a receiver of the *defendan-*

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*Section 40 of the New York Partnership Law provides that the relationship between partners shall be governed by the agreement between them.

ant's share of the profits, and of any other money due or to fall due to him in respect of the partnership. . . ." (Emphasis supplied).

That Thomas did not himself "realize" profits received by the other members of the firm is also demonstrated by provisions of the Internal Revenue Code. If such were not the case, then each partner would be taxed upon all the profits of the firm because the concept of realization as the touchstone of taxability has long been embodied in the tax law. *Helvering* v. *Horst*, 311 U. S. 112 (1940). But there can be no doubt that for tax purposes Thomas did not "realize" his partners' profit from the Tide Water transaction since each partner was required to pay taxes only on his distributive share of the profits. *Int. Rev. Code of 1954*, Section 702.

The Court of Appeals, in the *Rattner* case, refused to impose the liability on the defendant-director now sought (193 F. 2d at 565). The Court there held that the partner-director was not liable for any of the profits received by the other members of the firm.

Petitioner argues that this holding in *Rattner* turned upon the partner-director's lack of knowledge of the purchase and sale involved in that case. He further argues, based upon a suggestion in *Rattner*, that in the instant case liability upon Thomas for all the profits of the partnership should be imposed because soon after the first purchases were made, Thomas became aware of the firm's purchases of Tide Water common stock (R. 49a-50a). However, the significant factor justifying the imposition of such liability on the partner-director, according to this suggestion, is not knowledge but whether the partner-director "caused" the firm to make the short-swing transaction. In *Rattner* the court reasoned that since the partner-director was without

knowledge of the purchase and sale he could not have advised or caused the firm to enter such transaction (193 F. 2d at 565). While petitioner in this case argues that Thomas caused the purchase and sale of Tide Water stock, the evidentiary facts are to the contrary—and both the District Court and the Court of Appeals so found (see *supra*, p. 9). Moreover, the legislative history, (*supra*, pp. 18-20), demonstrates that Congress refused to impose liability upon a director, or any other insider, because he caused—a third party to realize "shortswing" profits.

Petitioner and the Commission seek to analogize this case to the case of *Walet* v. *Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (5th Cir.), *cert. denied*, 346 U. S. 820 (1953). In that case, the defendant-director purchased and sold securities of his company within a six months period. When the corporation instituted suit under Section 16(b), the defendant-director sought to defend on the ground that only one-half of the profits had been realized by him, the other one-half having been allegedly realized by his wife by virtue of the community property laws of Louisiana. The Court of Appeals for the Fifth Circuit rejected this defense on the ground that "the husband, under the law of Louisiana, is the head and master of the community and as such must be held accountable for his management thereof to the same extent as if it were his own" (202 F. 2d at 434). Thus the *Walet* decision is clearly inapposite here, as the Commission concedes in a footnote (SEC Brief, p. 20 n. 10), as a partner has neither the right, responsibility or duty of controlling the profits realized by his partners. See Opin. of Gen. Coun. of S. E. C., Release No. 175, 11 F. R. 10968, Apr. 16, 1935, describing those circumstances under which a husband would be deemed the owner of securities registered in his wife's name.

Petitioner further argues that the amendment of Commission Rule X-16A-3(b) in 1952 requires re-evaluation of

the *Rattner* decision insofar as it limits recovery against the partner-director to his share of the profits. This argument is also based on a false premise. First, the rule relates only to the reporting requirements of Section 16(a) of the Act. Second, the Act nowhere authorizes the Commission to create a substantive liability under Section 16(b) which Congress refused to impose. And, finally, in the Commission's own words, the rule was

> "... *not intended as a modification of the principles governing liability for short-swing transactions under section 16(b) as set forth in the case of Rattner v. Lehman, 193 F. 2d 564.* ..." (Emphasis supplied) S. E. C. Release No. 4754 (Sept. 24, 1952)

The express words of Section 16(b) make it clear that Congress has imposed liability on a director only for profits realized by him. It has not imposed any added liability upon a partner-director for causing others to purchase; it has not imposed a liability upon a partner-director for profits realized by other persons—whether they be his partners, his relatives, his friends or business associates. To impose upon Thomas the liability here contended for would require this Court to ignore the plain meaning of the statute, and its legislative history. " 'It is for [this court] to ascertain—neither to add nor to subtract, neither to delete nor to distort' ". *Flemming* v. *Florida Citrus Exchange,* 358 U. S. 153, 166 (1958). If the welfare of society requires that a director pay an issuer the profits realized not by him but by others, it is for Congress to expand the penalty to be exacted. The judgment as to Thomas must be affirmed.

IV

THE COURT OF APPEALS PROPERLY HELD THAT THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN NOT ADDING INTEREST TO THE JUDGMENT AGAINST THOMAS.

Authority for the addition of interest to the judgment against Thomas from the date of sale to the date of judgment must be found, of course, in Section 16(b) of the Securities Exchange Act of 1934. Cf. *Rodgers* v. *U. S.*, 332 U. S. 371 (1947). In *Board of Commissioners* v. *United States*, 308 U. S. 343 (1939), the court pointed out:

> "The cases teach that interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness. It is denied when its exaction would be inequitable." (308 U. S. at 352).

Speaking with regard to a judgment under Section 16(b), it has held that an allowance of interest from the time of realization of profit is not mandatory. *Magida* v. *Continental Can Co.*, 231 F. 2d 843, 848 (2d Cir.), *cert. denied*, 351 U. S. 972 (1953).

In the instant case, there are compelling reasons not to award interest to petitioner. Initially it must be noted that the amount of profits found by the District Court to have been realized by Lehman Brothers is a completely artificial figure which exceeds by more than three times the actual profit realized by the firm (See n. *supra*, p. 9). To award interest on Thomas' proportionate share of such profits would be penal and would transcend the remedial purpose of the Act. It must also be noted that Thomas himself did not receive any part of the $30,386.77 actually realized by the firm (*supra*, p. 10). To compel Thomas to pay

interest on sums never received or withheld by him would be inequitable in the extreme.

The question of whether or not to award interest was within the discretion of the District Court. The refusal to award interest in the circumstances here present was not an abuse of that discretion.

CONCLUSION

This Court should not disregard the findings below nor should it add a fresh category to those selected by Congress who must account for insider profits. The judgment below was clearly correct and should be affirmed.

Respectfully submitted,

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